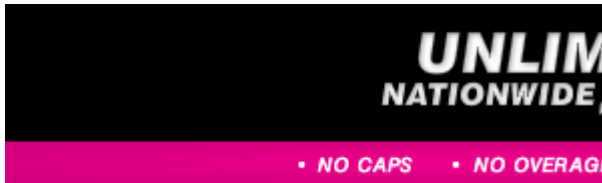


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## Small Business Financing

# Five Rules for Collecting Late Payments

By [Monica Mehta](#) on August 31, 2010

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*(Corrects spelling of Nager in the second to last paragraph.)*

The warning signs of a customer's cash-flow woes are easy to detect. Reduced orders, slowing payments, a change in phone number or business name, and a reluctance to get on the phone are all signs that trouble is brewing. Requests for duplicate invoice documentation or claims that "the check is in the mail" are also obvious stalling techniques. How should you respond to delinquent customers to improve your odds of getting paid? As business bankruptcies near a 16-year high, an informed response and a thorough credit policy are fundamentally necessary. Consider adopting the following five rules:

**1. Initiate direct contact after a payment deadline is missed.** The biggest mistake small business owners make is waiting too long to follow-up. The probability of collecting on a delinquent account drops dramatically each month following the due date, from 81 percent after two months to 52 percent after six months, according to the Commercial Collection Agency Assn. If an invoice remains outstanding for 12 months, the chance of collection drops to less than 25 percent, the trade group says.

"Demand letters rarely make a difference. Instead, get on the phone. Find out why the customer is late and nail down a defined payment arrangement," Steven Harms, a Birmingham (Mich.)-based attorney and collections expert, advises. Inquire about the state of the customer's affairs: Is business slow? Why are payments late? Customers operating in good faith will use this conversation as an opportunity to discuss their inability to pay and try to negotiate a revised arrangement.

Offering a discount for quick payment may also work in your favor, bumping your invoice to the front of a potentially growing chorus of creditors. Keep in mind that if things are going south for the delinquent customer, a bankruptcy court can claw back anything paid out within 90 days of a filing.

Before concluding the call, make sure you pinpoint a specific payment arrangement—including the amount to be paid, the deadline receipt, and the method of payment delivery. Ask your customer to sign off on a document summarizing the revised arrangement to make sure you are both on the same page; this documentation will be crucial should you find yourself in court.

**2. Take broken promises seriously.** If the new due date arrives and a check is nowhere to be found, the broken promise indicates that the customer is untrustworthy. At this point, you can hold back future deliveries, warranties, and service requests. Unless the customer is relying on your continued cooperation, however, you may have little leverage without taking more serious action. A past due bill will not show up as a strike on a credit report unless you take steps to file a claim in court.

**3. Contemplate hiring a collections agency or attorney.** Collections professionals specialize by industry and geography and are paid on their ability to collect—typically 10 percent to 25 percent of the invoice value. The bread-and-butter claims for the collections world range from \$1,000 to \$50,000, with smaller, younger claims usually being the easiest to collect. The best way to find a reputable agency or attorney is by seeking a referral from someone within your industry. Major industry trade associations, the [Association of Credit and Collection Professionals](#) and the [Commercial Collection Agency Assn.](#), can also offer recommendations.

**4. Review legal options.** Invoices under \$5,000 can be pursued inexpensively in small claims court. Larger claims must be filed in civil court, a process that is far more complicated and will require the assistance of an attorney. If the action goes undisputed, you may secure a court judgement within a matter of weeks. If the debtor decides to fight back, the resolution can take several months or longer. As defaults rise, more and more claims are making their way to court, creating a backlog in many jurisdictions. Be prepared for the process to take longer than it has in the past.

Even with a signed invoice and proof of delivery, the debtor still has the ability to fight back. The most common defense is to claim that the goods delivered were late, defective, or not as promised. Debtors tend to fight harder on claims over \$50,000. This is when the terms and conditions in your invoice, the steps you take to enforce those terms, and documentation of your correspondence—particularly anything in which the debtor admits in writing that it owes you for a past due invoice—will come in handy.

If the court awards a favorable judgement, the collections process is still far from complete. A judgement is worthless without assets that can be seized, and the creditor's attorney will now be forced to play detective. This is where a [detailed credit profile](#) can make or break the process. A social

security number, name of a banking relationship, trade reference, or old credit report can lead the way to property, bank accounts, or other assets that can be garnished by the creditor.

If this all sounds painful, that's because it is. "Your best defense against bad debt is a sound credit policy," advises Jocelyn Nager, a New York-based credit collections attorney with [Frank, Frank, Goldstein & Nager](#).

**5. Create a credit policy.** Don't operate by the seat of your pants. To start, take a look at the International Association of Credit Collectors' [guidelines](#). Collect extensive data at the onset of a credit application, with even tougher requirements for new businesses. Get credit-card details as a backstop to late payments. Invoices should contain detailed terms and be signed by buyers. Require late, damaged, or incomplete shipments to be reported in writing within days of receipt. Update your credit file every few months, particularly if the customer moves or changes phone number or company name. Also maintain a dialogue with your competitors, sharing news on customers. It's in everyone's best interest to cooperate.

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